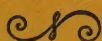


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# OPINION *AND* COMMENT



The Marshall Plan

Overlapping Federal and State Taxation. II

The Petrillo Case—"Feather-bedding" Solved?

Technological Changes in Agricultural Production

The Public Debt, Interest Rates, and Inflation



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# OPINION AND COMMENT

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of the

BUREAU OF ECONOMIC AND BUSINESS RESEARCH  
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HOWARD R. BOWEN, Ph.D., *Dean*

## CONTENTS

	PAGE
The Marshall Plan.....	1
KENNETH S. CARLSTON	
Overlapping Federal and State Taxation. II.....	8
EDWARD W. REED	
The Petrillo Case — "Feather-bedding" Solved?.....	16
C. C. CURTIS	
Technological Changes in Agricultural Production.....	20
P. E. JOHNSTON	
The Public Debt, Interest Rates, and Inflation.....	29
C. W. FRISTOE	

This publication of the Bureau of Economic and Business Research is issued upon the assumption that our readers will appreciate interpretative comments on topics of current interest. Because studied opinions on the significance of current trends are often more thought-provoking than tabulations of data would be, the Bureau supplements its research by issuing *Opinion and Comment* as another type of service.

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## The Marshall Plan\*

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### What Is the Marshall Plan?

THE year 1947 witnessed a growing concern by our officials with the plight of Europe. Despite very real progress toward prewar levels of production, Europe was not producing enough to supply her own minimum needs or to enable her to purchase on the world markets enough goods to meet those needs. On June 5, 1947, in a speech at Harvard University, Secretary of State Marshall stated the willingness of this country to aid in the task of European economic recovery but said that "the initiative . . . must come from Europe" and that it was for the countries of Europe to work out "some agreement . . . as to the requirements of the situation." As Secretary Marshall said a few months later: "There was no plan. There was a suggestion."

The past several months have seen the development of that "suggestion" into a Plan, the Plan presented to the Congress of the United States by the President on December 19, 1947. "Emergency relief" is not a part of the Plan. Economic reconstruction is the objective. To this end, it is proposed that we supply the 16 European countries that

are participating in this cooperative attempt to "make both ends meet" with (1) food; (2) supplies and raw materials including fuel; (3) equipment or capital goods; and (4) a certain amount of money.

### Why Does Europe Need Aid?

War and the weather brought Europe to its present plight. Not alone the destruction of war—which was on a prodigious scale—but all the dislocative forces engendered by war. And not merely one blow of bad weather, but a freezing winter of such intensity that it froze seed in the ground, followed by spring floods that washed out crops and topsoil, ending with a burning summer drought that destroyed the already thin crops. The French 1947 wheat crop was the smallest on record.

The economy of Europe was a highly integrated economy. Some 270,000,000 people are found in the 16 participating countries and Western Germany. They produced for the world market and lived by international trade. They had nearly half of the international trade of the

<sup>1</sup> The 16 countries participating in the Marshall Plan are the United Kingdom, France, Italy, Belgium, the Netherlands, Denmark, Austria, Greece, Iceland, Ireland, Luxemburg, Norway, Sweden, Switzerland, Portugal, and Turkey.

\* The substance of this article was presented in a talk over Radio Station WIL, on January 4, 1948.

world. By selling highly specialized products, shipping services, and "tourism" to the world, and by their income from their foreign investments, they were able to maintain a high standard of living. But it was a type of economy that could be readily disrupted; it was delicately articulated and complex.

The problem Europe is facing today is not alone the restoration of its productive facilities. The problem is one of "dollar shortage"—one, in brief, of making both ends meet. Former sources of supply and trade in Eastern Europe are cut off. The pipe lines of food, raw materials, and timber from the East are shut down by Russia's decision that neither she nor her satellite states would have any part of this venture suggested by Secretary Marshall; in the words of her representative at Geneva, this would amount to "the violation of the sovereignty and independent political and economic development of European states!" A more realistic explanation lies in Stalin's words in "Leninism" that "experience has shown that stabilization of the capitalist economy of Europe cannot be secured without access to our markets and to our sources of raw material" (Vol. 1, p. 374). Europe's markets in the Far East, and their source of foreign exchange for trade with the United States, are largely gone. Colonial trade patterns are disrupted. Merchant fleets as a source of revenue are sadly depleted. Foreign investments have been drawn down to pay for war debts and current consumption; hence the margin of income from

"invisible exports" is largely gone. Within Europe, physical resources are depleted and destroyed. Workers are suffering from strain and exhaustion. Coal and steel for industry are lacking. Fertilizers for farming are insufficient. Yet the shattered economy of Europe must find ways to feed some 24,000,000 more people in Europe than were living there before the war. The consequence is that there is a per capita dietary reduction ranging as high as 35 per cent of the prewar amount. The average city dweller in Italy, Austria, and Germany subsists on food containing only 1,950 calories a day. American daily consumption is almost twice that, 3,400 calories. And remember that the calorie is only a measure of the heat energy contained in food. It tells nothing about whether the diet is balanced and contains adequate food elements.

Consider, for example, the problem of fertilizers. One ton of nitrogen will produce 12 additional tons of wheat. Europe has idle capacity for producing nitrogen which is more than adequate to satisfy her present shortage of nitrogen. But it takes seven or eight tons of coal to make one ton of nitrogen. We find that coal is short because of (1) insufficient food for miners, (2) lack of machinery, and (3) lack of transport. The last two causes are in turn caused by the lack of steel; finally, there is not enough steel because there is not enough coal. And Sweden, which formerly furnished wooden props for mines, is burning wood for coal because it does not have enough coal to meet its fuel needs.

Hence, Europe needs (1) food, (2) supplies and raw materials including fuel, and (3) equipment or capital goods as a catalyst to restore the process of production. Chemists, in endeavoring to find a new way to make a product, will introduce a catalyst and find that an inert body of materials is fused with life and creation. So here, Europe can no longer continue to supply its people with their human needs without outside assistance.

But why the need for money, the fourth element in the Marshall Plan? An obvious, but only a partial, answer is that it is a medium of exchange and will enable the participating countries to reach their goals in the most efficient manner by buying what they most need where it is most readily obtainable. It will, moreover, enable purchases of tight commodities to be made outside this country and with the least injury to our economy. All of the iron ore, 98 per cent of the meat, 92 per cent of the sugar, three-fourths of the timber, over two-thirds of the fats and oils, and more than half of the bread grains will be supplied from outside the United States.

The rest of the answer as to the need for money lies in the necessity of quelling the inflationary forces which plague the European financial economy. Even in Russia, we now find, money supply must be brought into stable relationship with the supply of goods. The war saw a pouring out of liquid money in payment for war production, coupled with a constant shrinkage in the volume of consumer goods for

which that money might be spent. The reconstruction program of post-war days sees quantities of liquid money being poured out in payment for the making of capital goods, together with continued undersupply of consumer goods. Resulting price inflation drives current production and supplies away from normal markets and in turn contributes to the inflationary spiral. Central bank advances to defray governmental costs add to the supply of liquid money. Somehow these inflationary forces must be brought to an end. The funds made available through the sale of goods supplied under the Marshall Plan can be used by the governments concerned to accomplish deflationary measures. Central bank gold reserves can be strengthened out of loans from this country.

### What Does Europe Propose to Do for Itself?

The 16 participating countries have a fourfold plan of action for self-aid. They do not supinely look to the United States for a continuing program of "emergency relief." They propose first a vast program to increase their own capacity and output. They see their "dollar shortage" realistically as a deficiency of production and exports. They propose to remedy this by reaching production goals in 1951 such as: (a) coal in 30,000,000 tons over the 1938 level; (b) steel in 10,000,000 tons (or one-fifth) over the 1938 level; (c) oil-refining capacity two and one-half times the prewar level; (d) electric generating capacity

two-thirds above the prewar level; (e) inland transport facilities one-fourth larger than in 1938; (f) restoration of prewar merchant fleets, and (g) restoration of prewar output of bread grains and cereals. Second, they propose close economic co-operation on a permanent basis so that the maximum use will be made of their respective resources in reaching their production goals. They look to achieve, in the third place, internal financial stability and, fourth, a solution of their deficit with the American continent. Their proposals, if carried out, will mean the substitution of economic interdependence and cooperation for nationalistic rivalries.

### Why Should We Aid Europe?

We look for a world in which there is prosperity and security. We have learned that we can achieve neither in isolation. Political insecurity creates fear and a consequent diversion of production from the goods of peace to the munitions of war. Economic insecurity heightens the drive for national self-sufficiency and retreat from the risks of multilateral trade. The climate of peace is found in industry and trade. It is a significant fact that the greatest war in world history was preceded by a great world-wide depression.

In 1938, the 16 participating countries took 35 per cent of our total exports and supplied 21 per cent of our total imports. In 1946 they took 33 per cent of our total exports and supplied only 14 per cent of our total imports. The restoration of this trade on a self-sus-

taining basis is essential to our welfare. Without it, all our efforts to restore world trade through the World Bank, the proposed International Trade Organization, and all the other agencies we have created for this purpose become of no avail. Trade with the 16 participating countries is a vital part of our foreign trade and of world trade. A healthy European economy is essential to the preservation of world peace.

More than ever before, imports are essential to our economy. Our present level of production is two-thirds higher than before the war. To sustain that production we must import, for we are no longer self-sufficient in certain strategic materials. Before the war we exported copper; we now import it. We are becoming a petroleum-importing country rather than an exporting country. We are beginning to look abroad for iron ore supplies. Britain must *export* or die; we must *import* or die.

We also look for security. The fateful four years of the Marshall Plan, 1948-1951, may—if we do not act—see the United States slip from the greatest economic and military power in history to a second-rate world power. For if Europe lapses into economic chaos, it will be at the sacrifice of the traditions of liberty and parliamentary government built up through the centuries. With Europe no longer a part of the democratic world, the naked fact is that the balance of power will shift to our loss, to the loss of the European society, and to the loss of the world.

## If We Aid Europe, Won't We Be Pouring Money Down a Rathole?

Enough has already been said to indicate the complexities and ramifications of the problems tied up in the phrase, "the Marshall Plan." Some of our slogan makers, who deal in half-truths and substitute pat phrases for the uncomfortable realities of facts, have come forth with the formula "Operation Rathole" and would thus neatly cast aside all these troublesome facts. If an analogy must be sought, a truer one is found in the floods that often beset our Midwest river valleys. The workers who valiantly toil at levees do not cease piling sandbags because the river may eventually engulf them. Their homes, — their way of life — must be fought for. Though the struggle may be lost it must none the less be made. We can do no less if we are to bring back something of the world we once knew.

## Why Should We Help Socialist Governments?

The issue has become one not of the existence of socialistic controls — though no country of western Europe is wholly or even in large part socialistic in its control of economic life — but of the existence of freely chosen governments. The issue is whether the expanding power of the Soviet Union, which as a result of World War II added 260,000 square miles inhabited by some 23,000,000 people to its territory, is to bring within its orbit the 270,000,000 people of western Europe.

## Why Should We Help "Lazy" European Workers?

Despite the exhaustion and strain of six years of war and enemy occupation, despite inadequate diets, despite pitifully low "real incomes," the European worker has done wonders of production. Textile output for 1947 will probably reach 1,400,000 tons as against an estimated 1,600,000 tons prewar. Cereal production has reached 86 per cent of prewar output, potatoes 88 per cent, oils and fats 71 per cent, meat 65 per cent, coal 80 per cent, steel approximately 66 $\frac{2}{3}$  per cent. France, Belgium, and the Netherlands have reached a rate of industrial production 80 to 90 per cent of prewar.

## If We Give Aid on the Scale Proposed, Won't We Wreck Our Economy?

Two Presidential committees have considered our *capacity* to extend foreign aid and the *internal effect on our economy of extending aid*. Each has made its report public. Another Presidential committee, the Harriman committee, has considered these findings and has itself made a final report concerning the extent to which we can safely assist in foreign recovery and the means for handling this task. What are the pertinent facts?

In 1946 our total exports were 15.3 billion dollars, with an export surplus of 8.1 billion dollars. The rate of export fluctuated from 21 billion dollars a year in the second quarter of 1947 to 18.3 billion in

the third quarter. Government financial aid financed about four-fifths of the export surplus in 1946 and nearly all of it in the second quarter of 1947. The Marshall Plan will continue this high rate of export in 1948, but its effect on our economy is likely to be less severe. Let us look at the rest of the record. From our national income, consumer spending takes the huge chunk of 164 billion dollars. Government and business spending take about 30 billion dollars each. Buying by foreigners in 1948 will be in a market in which the capacity to produce is increased and in which certain elements of domestic demand will be less strong. For example, a considerable part of industry will be completing its initial postwar program of capital expansion, and this portion of demand will therefore decline. The load on our economy will, in short, be no greater than in the past and probably will be less.

This is not to say that some phases of the European demand will not be critical. Grain, coal, fertilizer, and steel and steel products, including certain essential equipment, are insufficient for the needs of both this country and Europe. These commodities occupy strategic spots in the American market and will, in the words of the Council of Economic Advisers, "require export controls, allocations for domestic use, discouragement of misuse or excessive use, efficient transportation and distribution, and the curbing of speculation and hoarding of goods." No, our econ-

omy will not be wrecked, but we must husband our resources and see that they are used wisely.

### **Are the Risks and Rewards Worth the Investment?**

The costs of the program cannot be dismissed lightly; it entails serious sacrifices. The President has asked for 17 billion dollars in aid over a four-year period. With our economy thus continuing at full blast, prices will move down very little, if at all. Troublesome bottlenecks will continue. And there can be no guarantee that the Plan will be successful. But, as Secretary Marshall said to Congress, the "risks have been carefully calculated, and I believe the chances of success are good." The economic situation in Europe is of profound importance to our well-being, and if Europe's political independence should be lost to another foreign power the consequences to this country would be staggering. In the words of the President, we might well be compelled "to modify our own economic system and to forego, for the sake of our own security, the enjoyment of many of our freedoms and privileges."

The American people are now entrusted with a great responsibility. Before their eyes they have seen develop a basic question in our foreign policy. They have seen foreign policy in the making: the stating of the basic problems and the proposed solution, the detailed investigation of the subsidiary problems involved, the consideration and analysis of the resulting reports,

and finally the presentation of the final program by the President to their representatives in Congress. Step by step the "suggestion" has progressed until the "Plan" now lies in the hands of Congress and the

people. There will be much debate; some of it wise and informed and some of it with passion and demagoguery. But at the time of decision we can safely count on the wisdom of the American people to prevail.

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**Tax Reduction.** Instead of cutting taxes now, immediate preparations should be made for the overhauling of the entire tax structure by placing it on a more equitable basis and providing real incentives for work and for risk taking. A new tax measure should be in readiness to be put into operation in the event of a business let-down, at which time a tax reduction would be a stimulating and constructive influence. . . . In conjunction with the postponement of a tax reduction, the Government should be called upon to curtail sharply Federal expenditures which are running nearly five times the rate of the prewar period. Any economies effected in this connection should be used for debt retirement. The reduction in Federal expenditures would also lessen the pressure in the market place where the Government competes with private enterprise for materials and labor. The Administration should champion the cause of Governmental economy and thus stand ready to match the sacrifices it asks the people to make in foregoing tax relief at this time.—From *New England Letter* (First National Bank of Boston), December 31, 1947.

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**Consumer Incomes and Expenditures.** In an effort to maintain customary living standards in the face of mounting prices, consumers generally spent greater percentages of their larger incomes in 1947 than in 1946, drew further on accumulated savings, and made increased use of credit facilities. As a result consumer expenditures in the nation as a whole reached approximately 165 billion dollars, almost 15 per cent above the 1946 level. . . . In spite of the upward over-all trend in consumer expenditures, however, there is considerable evidence that many individual goods and services are receiving increasing consumer buying resistance, and all purchases are being made with added attention to price and quality. Many low quality (or off-brand) items among types of goods still generally in strong demand disappeared from the markets during 1947. Some luxury goods and services, after slumping during the early part of the year, have revived somewhat since.—From *Business Conditions*, Federal Reserve Bank of Chicago, January, 1948.

# Overlapping Federal and State Taxation. II\*

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THE previous article pointed out that the problem of conflicting taxation arises because the Federal government is empowered by the Constitution to levy taxes and the states, in consequence of their inherent right of sovereignty, also impose taxes. As a result, both the Federal and the state governments levy nearly every type of tax. Complete separation of revenue sources is found only in customs duties and the property tax.

Only within the present century have the effects of overlapping taxation become so evidently detrimental that several reforms have been proposed, namely, separation of revenue sources, the sharing of taxes, tax credits, and supplements.

The first proposal, separation of revenue sources, would assign certain fields of taxation specifically to the Federal government and others to the states. Under the second method suggested, the tax would be administered by a single governmental unit, which would share the proceeds with one or more other units. The third procedure, the use

of a tax credit, implies the levying of the same tax by both Federal and state governments, but the former would credit a certain part of the tax to the states. If the fourth plan were used, one government would be authorized to superimpose additional tax rates on the rates levied by another, with the administration of the tax assigned to the government best qualified to perform that function.

A discussion of these four proposals and their probable effects on the taxation of personal and corporate incomes was presented in the November issue of this publication. This article deals with four other fields of taxation in which the problem of conflicting taxation arises: the transfer of property at death; tobacco; gasoline; and alcoholic beverages.

## Taxation of the Transfer of Property at Death

Two of the most important problems in state taxation of the transfer of property at death are those of jurisdiction and domicile, both of which have resulted in double taxation. The Supreme Court, in a series of decisions beginning in 1925, attempted to eliminate double taxation by assigning a taxable situs to intangibles, but in 1939 it reversed

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\* This is the second of two articles on the topic of conflicting taxation. The first, which dealt with the taxation of personal and corporate incomes, appeared in the November, 1947, issue of this publication.

this line of reasoning. Also, from 1925 on, the states attempted to eliminate this problem by entering into reciprocal agreements, but since the Court by 1932 had determined the taxable situs of intangibles, the movement was brought to a standstill. In fact, some states, believing that the problem was settled, repealed their reciprocal clauses. Even though some states still have reciprocal arrangements, double taxation in this field is not uncommon. Since there is no acceptable definition of domicile and the courts seem reluctant to give one, it is possible for a decedent to have more than one domicile; as a result, his estate may be taxed by two or more states.

State administration is characterized by decentralization, whereas that of the Federal government is centralized. In the states, instead of responsibility for the administration of the tax on the transfer of property at death being vested in a single agency, as in the administration of the income or gasoline tax, a series of agencies participates in the administrative process. In approximately 60 per cent of the states the probate courts are entrusted with administration. In many instances the courts have no financial interest at stake, and as a result the process may be conducted in a haphazard fashion.

The use of supplements, with the Federal government administering the tax, would not solve the problem involved in inheritance and estate taxes. Because the various state tax laws differ so widely, it

is doubtful whether Federal administration would reduce administrative costs. The problem of double taxation would be present, and since the states would still be free to determine their own rates and exemptions, tax competition would not be precluded.

Some coordination has already been achieved between the Federal government and those states which levy a tax on the transfer of property at death. The coordination was instituted in 1924 in the form of a Federal credit. This credit was introduced in an effort to eliminate interstate competition for wealthy residents and to encourage uniformity among the states, so that inheritance and estate taxes could be established as a dependable and productive source of state revenue. The absence of such taxes in some states and the nonuniformity of tax rates in others offered an inducement to many wealthy individuals to change their domiciles and, by doing so, avoid relatively high taxes.

The adoption of a Federal credit has not resulted in the attainment of the desired objectives. The credit has encouraged the states to adopt taxes on the transfer of property at death, but it has not resulted in complete uniformity. The use of the credit does not guarantee such uniformity, for it is still possible for a state to levy taxes which exceed the Federal credit if it needs additional revenue. Since the adoption of the Federal credit, the Federal law has been amended several times; the rates have been revised upward and the exemptions downward. The

credit, which does not apply to these revisions, is still tied to the antiquated law of 1926.

The main advantage of Federal collection and state-sharing in inheritance and estate taxes would be the reduction in the cost of administration and the possibility of arriving at a uniform rule concerning the taxable situs of intangibles. Since most estates are concentrated in the more wealthy states, sharing on the basis of population or income payments would probably be opposed by those states. Because it is possible that the states might not agree on a basis of sharing and because a relatively small amount of revenue is involved, a sharing program does not seem warranted.

As a means of solving the problem of conflicting taxation in the taxation of the transfer of property at death, it seems that separation of sources, with exclusive taxation delegated to the Federal government, offers the best solution. The Federal government is best qualified to administer such a tax. The question of domicile would no longer be a problem if the Federal government were given this source of revenue. The possibility of multiple taxation of intangibles because of jurisdictional conflicts would be eliminated. It is true that the states would lose some revenue, but this might be made up from other less objectionable sources.

A single Federal tax would result in a uniform rate and thus eliminate tax competition among the states. Consequently, wealthy residents would gain no advantage by moving

from one state to another to escape high taxes. It would result in a greater fluidity of the population since any decedent's estate would be treated the same in every state.

### Taxation of Tobacco

State administration of the tax on tobacco has several shortcomings as compared with Federal administration. Administration by the states is decentralized, since they are forced to collect the tax from a large number of wholesalers and retailers. Collection from a large number of taxpayers results in increased costs and a greater chance for avoidance and evasion of the tax. The placing of stamps on the outside of the cigarette package as evidence of payment of the tax is a relatively expensive process. All the states but one allow a discount, which ranges from 5 to 10 per cent of the value of the stamps or metering impressions, to the dealers to cover the cost of affixing them to the package. Evasion and avoidance of the tax by purchasing out of state have presented a serious problem to the state administrators. Since the Federal government collects the tax from producers and importers of tobacco products, the chances of evasion are small and the cost of collection is reduced.

Neither a Federal credit nor the use of supplements would solve the problems involved in the taxation of tobacco. Use of a credit would result in the Federal government's collecting the tax within the borders of each state which levies such a tax. Since the tax would not be

collected at the point of greatest concentration, the costs of collection would increase. Avoidance and evasion of the state tax would still be possible, since the states would still be free to exceed the credit if additional revenue were needed. If the Federal government administered the tax and the states were permitted to add rates, the cost of collection would be increased because the tax would be collected from the many dealers in tobacco products in the various states which levy the tax. Avoidance and evasion of the tax would not be precluded, since the states would still be free to determine their own rates.

Federal collection and state-sharing would have some advantages over the present method of taxation. The cost of collection would be reduced and avoidance and evasion would be eliminated, since a uniform rate would be established. The basis on which to share the proceeds of the tax would raise a problem. The amount sold within the states would probably be the most acceptable basis, but the collecting of this information would involve much bookkeeping. Since the tax is relatively unimportant to the states, it seems that a sharing program would not be warranted.

Separation of sources, with the right to levy a tax on tobacco delegated to the Federal government, seems to be the best solution. Even though this method would involve some loss of revenue to the states, other sources of revenue might well be sought.

## Taxation of Gasoline

The states have encountered some problems in the administration of the tax on gasoline. By 1929, when every state and the District of Columbia had enacted a tax on gasoline, evasion became profitable because of increased rates, the lack of uniformity in tax rates among the states, and the increase in the number of distributors. The most serious problem in administration was that gasoline was "smuggled" into those states with a higher tax rate than an adjoining state. Recently the states have resorted to reporting gasoline shipments to each other in an effort to reduce the evasion of the tax due to interstate shipments. This is the most progressive step made in the administration of the state tax in recent years.

The Federal government has some administrative advantages over the states in the field of taxation of gasoline. The tax is levied on the manufacturers and importers of gasoline. Tax evasion or avoidance does not present a problem to the Federal government, because of this element of concentration and the uniform rate.

Neither a Federal credit nor the use of supplements would seem to be a logical arrangement in the taxation of gasoline. The same criticisms can be made of them here as in the taxation of tobacco. Federal collection and state-sharing would have some advantages over the present method of taxation. Since the Federal government collects the tax from relatively few taxpayers,

the cost of administration would be reduced. The problem of evasion would no longer be present, since the tax would be uniform.

A sharing program would not take into consideration the needs of the states. Some states entered the highway building program late and as a result need more funds for this purpose than do others that have a well-developed program. If the tax on gasoline were shared on the basis of the amount of gasoline consumed within the state or on the basis of improved roads or on the basis of population, this fact would not be taken into consideration. If the sharing program did provide the funds needed by those states that now levy a relatively high tax on gasoline, some states might receive more than they actually need for the construction and maintenance of highways.

Separation of sources, with the states having exclusive right to tax gasoline used on the highways and the Federal government having exclusive right to tax aviation gasoline, seems to be the best solution. The tax on gasoline forms a relatively important and much needed source of revenue for the states. Only payroll and the general sales taxes are more important to the states as revenue producers. The states lack some of the administrative advantages possessed by the Federal government but, of the three excises studied, the administration of the tax on gasoline is much more efficient than that of tobacco or alcoholic beverages. The practice of making reports of inter-

state shipments is a great improvement in solving the problem of evasion of the tax.

Since the adoption of the first tax on gasoline by the states, this tax has been closely associated with the development of state highways. Even though it is difficult to measure benefit, there is still a belief on the part of the taxpayer that taxes on gasoline are closely related to the benefits he receives. The Federal tax on gasoline lacks the more generally recognized benefit aspects that are possessed by the state taxes. It was enacted in 1932 as a matter of expediency, long after the era of highway construction began. It is true that the Federal government does give grants to the states for highway purposes, but these grants are in no way based on the amount of revenue collected from the Federal tax on gasoline. Federal aid is given in consideration of broad national interests. The states have been responsible for the construction of highways and therefore, it seems, should be free to exploit this field of taxation. The variation of tax rates among the states is not desirable from the standpoint of evasion, but they can be justified because of the varying needs of the states. Some states entered the program of building highways late and, as a result, must make greater use of this source of revenue.

State taxation of aviation gasoline in most instances lacks the benefit principle that is present in the taxation of gasoline used on the highways. A small percentage

of the amount collected by the states is spent for aviation purposes. State taxation of aviation gasoline is not so effective as the tax levied by the Federal government. Thus, it seems that since the aviation industry is one that is national in character and the Federal government is best adapted to taxing the fuel, exclusive taxation thereof should be delegated to the Federal government.

### **Taxation of Alcoholic Beverages**

State taxation of alcoholic beverages has raised some problems. Since the states are forced to collect the tax from distributors, the cost of collection has been relatively high. The nonuniformity of tax rates has also encouraged consumers to purchase across state lines in order to avoid the tax. To aid in the collection of the tax on alcoholic beverages and to prevent evasion of the tax, the states permit only licensed distributors to import alcoholic beverage products. Even though this may be advantageous to state administration, it results in a higher cost of the products since the licensed importer must be compensated for his services.

The states have used their power of taxation for purposes other than the raising of revenue. This power, coupled with the broad power of control provided in the Twenty-first Amendment, has been used to erect tariff barriers against alcoholic beverages produced out of state. Higher license fees have been required from out-of-state distributors than from those distributing products produced domestically.

This has been especially true in the distribution of wine. Higher tax rates have also been levied on alcoholic beverages produced out of state. Since the Twenty-first Amendment has given the states power to control the transportation and importation of alcoholic beverages, the Court has held trade barriers not in violation of the commerce clause of the Constitution. Thus, it seems that the states may indulge in any form of regulation and to any extent they choose.

The establishment of trade barriers is for the most part an offspring of the depression of the thirties. Trade barriers limit competition and make it possible for a sub-marginal producer to remain in business. Even though a few people may benefit temporarily, the public will suffer in the long run, and, in many cases, the barriers injure those whom they were designed to help. The cost of the article is increased, and the consumer is forced to pay a higher price for the product.

The Federal government has some advantages over the states in the administration of the taxes on alcoholic beverages. The tax is collected from the distilleries, rectifiers, importers, wineries, breweries, and bonded warehouses. Collecting the tax at the point of greatest concentration offers less chance for evasion of the tax than when it is collected from distributors in the states.

The use of a Federal credit or Federal administration, with the states permitted to add supplemen-

tary rates, does not seem to present a solution to the problems involved in the taxation of alcoholic beverages for the same reasons as were presented in regard to the taxation of tobacco and gasoline.

Federal collection and state-sharing would have some advantages over the present method of taxing alcoholic beverages. The cost of administration would be reduced since the Federal government would be collecting the tax from a limited number of dealers and at the point of greatest concentration. The uniform rate would result in the elimination of evasion due to purchases made in those states where the tax rate warranted a lower retail price, as well as trade barriers due to a tax-rate differential. A sharing program should include a provision limiting the states to the use of the power to license, and, in that way, trade barriers would certainly be reduced. This limitation could take the form of a ceiling on the amount the states could charge for a license, which probably should not be more than \$200. Probably the most acceptable basis on which to share the revenue collected by the Federal government would be the amount of alcoholic beverages sold in each state. This method, however, would involve much bookkeeping since the information would have to be obtained from the licensees.

Withdrawal of the states from the taxation of alcoholic beverages in favor of the Federal government would solve many of the problems involved in this field of taxation since the Federal government has

many administrative advantages over the states. If the states retained their right to impose license fees, however, the problem of trade barriers would not be solved. It would seem desirable that the states should limit the size of their license fees in an effort to reduce trade barriers.

The main objection to giving the Federal government the exclusive right to tax alcoholic beverages is that it would deprive the states of a relatively important source of revenue. The decision as to whether the states should withdraw from the taxation of alcoholic beverages seems to depend upon whether they could make up the loss from some other source. If the amount could be offset by revenue from the tax on personal income through a sharing program, the states might well withdraw in favor of the Federal government. If, however, this loss could not be offset from other sources, Federal collection of the tax on alcoholic beverages and sharing a part of the proceeds with the states would be an improvement over the present method of taxation.

None of the coordinating devices offers a solution to the problem of "bootlegging." This can only be solved by strict enforcement and a reduction of tax rates so that it will become unprofitable for the bootlegger to operate.

### General Conclusions

Conflicting taxation between the Federal government and the states, and among the various states, seems inevitable so long as we have our

present system of dual sovereignty with both governments exercising their powers of taxation. Such overlapping has resulted in unjust taxation, high administrative costs, many instances of evasion due to the fact that some governments have levied taxes which they are not able to administer efficiently, high compliance costs, and tax competition. Some may consider them the inescapable price of federalism and resent any change on the ground that centralization violated the concept of "states' rights." It does seem, however, that considerable improvement, which would minimize the results of these conflicts, could be brought about, within the framework of our existing system of government, through the development of some of the coordinating devices studied.

Many of the inequities and wastes in state tax administration which are a result of conflicts between the states would be remedied by the adoption of some of these devices. The double taxation of personal and corporation income, as well as of intangibles transferred at death, would be eliminated. The problem of tax avoidance and evasion would

be held to a minimum. In many instances the cost of administration would be reduced, and trade barriers that are the result of the taxing powers of the states would be lessened. The solving of these problems would result in greater freedom of movement of the factors of production, which is necessary for the functioning of our national economy.

The adoption of the coordinating devices recommended would not be an easy task. The fiscal systems of the Federal government and the states would probably be disturbed for a short time, but any degree of reorganization of the Federal and state fiscal systems must be evaluated in terms of the long run. The possible use of any coordinating device requires some willingness on the part of both the Federal government and the states to compromise and to view our dual system of government as a unit rather than as two distinct, independent, and conflicting governments. To make the tax system less complicated, more efficient, and more productive will require sincere cooperation among Federal and state officials and the public.

# The Petrillo Case — “Feather-bedding” Solved?

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A COURT decision which may affect the development of the law on industrial relations was that rendered by the United States Supreme Court in June, 1947, in the case of the United States v. James C. Petrillo. The decision involved the validity of the Lea Act, which was passed by the Federal Congress in April, 1946.

That law, passed as an amendment to the 1934 Communications Act, made it unlawful for one to coerce, compel or constrain, or to attempt to coerce, compel or constrain, a licensee broadcasting station to employ “any person or persons in excess of the number of employees needed by such licensee to perform actual services.”

The defendant was accused by the government in a criminal information of attempting to coerce a Chicago broadcasting station to hire three musicians who the station contended were not needed. The station had hired three union musicians as “librarians.” The three were not employed to play instruments, but to take care of the station’s recordings. At the expiration of their contract in May, 1946, it was alleged that the defendant demanded that the station hire three additional union musicians as “librarians.” The station refused to do so on the

basis that an additional three were not needed.

It was alleged that the coercion was accomplished by causing the three employed “librarians,” members of a Chicago musicians’ union, to discontinue their employment and to refuse to accept further employment by the station, and by causing the station’s place of business to be picketed.

The defendant moved to dismiss the information on the ground that the Lea Act on which it was based was invalid because it (1) abridged freedom of speech in contravention of the First Amendment to the Federal Constitution; (2) was repugnant to the Fifth Amendment because it defined a crime in terms that were excessively vague and denied equal protection of the law and liberty of contract; and (3) imposed involuntary servitude in violation of the Thirteenth Amendment.

The Judge of the District Court dismissed the information, holding that the Lea Act on which it was based violated the three Amendments heretofore mentioned, thus upholding the defendant’s contentions in full.

The Government appealed the ruling to the United States Supreme Court. The case was argued before

that body in May, 1947, and the Supreme Court rendered its decision June 23, 1947.

That Court, by a vote of five to three, sustained the validity of the Lea Act, and remanded the case to the District Court for further action.

The Court's opinion, given by Justice Black and concurred in by Chief Justice Vinson and by Justices Burton and Jackson, stated that the language used by the Congress in the Act provided an adequate warning as to what conduct fell under its ban and that it marked boundaries sufficiently distinct for judges and juries fairly to administer the law in accordance with the will of that body. The Federal Constitution required no more than that the language used be sufficiently definite as to the proscribed conduct when measured by common understanding and practices. Equal protection of the law did not require the Congress, in prohibiting some practices within its power, to prohibit all within its power. It was no objection that the law did not prohibit the employer radio broadcaster from voluntarily hiring more employees than he needed.

Further, in reply to the assertion that the language of the Act was indefinite and vague, Justice Black said: "Clearer and more precise language might have been framed by Congress to express what it meant by 'number of employees needed.' But none occurs to us, nor has any better language been suggested, effectively to carry out what appears to have been the Con-

gressional purpose. The argument really seems to be that it is impossible for a jury or court ever to determine how many employees a business needs, and that, therefore, no statutory language could meet the problem Congress had in mind. If this argument should be accepted, the result would be that no legislature could make it an offense for a person to compel another to hire employees, no matter how unnecessary they were and however desirable a legislature might consider suppression of the practice to be."

But, while noting that the District Court had held the Lea Act invalid in that it violated the First Amendment to the Constitution "by its restriction upon freedom of speech by peaceful picketing," and the Thirteenth Amendment because it "imposed involuntary servitude" on an employee by depriving him of his "right" to leave employment singly or in concert with others, Justice Black stated, in the majority opinion, that he thought that the District Court had reached these conclusions prematurely, as the Act did not mention picketing, peaceful or violent, and did not prohibit employees from striking. He felt that the lower court had ruled on the statute as it might have been applied on the information as the latter then read, rather than on the statute as written. He thought that the Supreme Court should not attempt to pass upon some possible application of the Act to particular persons in a particular set of circumstances in advance of the necessity to do so, in that the statute had

not been and might never be so applied.

Consequently, the majority opinion does no more than hold that the Lea Act is constitutional "on its face." It does not state that a conviction of coercing an employer radio station into hiring more employees than the "number of employees needed" will be valid, if the coercion was accomplished in whole or in part by a strike or by picketing. The fact is that one might readily infer from the wording of the opinion that Justice Black and the other Justices concurring therein would hold that such practices were permissible under the Lea Act if a case came before them presenting the question.

Strikes, threats to strike, and picketing have been the most effective methods used by members of unions and their officers to enforce their demands upon employers. If such practices can be continued without prohibition by any law, then it would seem that the Lea Act and any other statutes enacted to make "feather-bedding" illegal must necessarily fail in their purpose.

Justice Frankfurter wrote a concurring opinion. He found that the constitutional basis for the Lea Act was the same as that upon which the Sherman Act rested. The Congress had the right to free interstate commerce from an obstruction that the exercise of monopolistic power might entail or from interference that might reasonably be deemed to promote monopoly. That body could direct its legislation toward a disclosed evil without generalizing

its prohibition, when in its judgment like evils had not disclosed themselves elsewhere. He thought, however, that the majority of the Court had conjured up difficulties in which he did not share. As the matter before the tribunal was "a naked question of validity," he felt that it was not for the Court to scrutinize the charge and to hypothesize possibilities whereby new questions might arise of a statutory or constitutional nature.

His concurring opinion adds nothing to the majority opinion except the inference, which one will obtain from reading it, that he might support a conviction under the Lea Act if it were based in whole or in part on coercion by use of the strike or of picketing.

Justice Reed dissented, on the basis that the Lea Act was too indefinite in its description of the thing for which force must not be used—that is, "to compel" a licensee "to employ . . . any person or persons in excess of the number of employees needed by such licensee to perform actual services." He stated that the Anglo-American law did not punish citizens for violation of vague and uncertain statutes, and that an act should be held to be invalid when its wording was so vague that men of common intelligence must necessarily guess at its meaning. He questioned "How can a man or a jury possibly know how many men are 'needed' 'to perform actual services' in broadcasting?" He seemed to think that such a matter was one that only Congress should determine, or that it should

be left to the rules and regulations of the Federal Communications Commission or other regulatory body. He did not consider any contention raised by the defense other than that the Act denied equal protection of the law in that it defined the crime in terms excessively vague. There is nothing in his dissent from which one can gain any inference as to his opinion whether a law against "feather-bedding" could bar coercion by use of the strike or of picketing.

Justices Murphy and Rutledge joined in Justice Reed's dissent. Thus, the decision of the Supreme Court in the Petrillo case sustaining the validity of the Lea Act "on its face" was by a vote of five to three.

Justice Douglas took no part in the consideration or decision of the case. As he has often joined Justices Murphy and Rutledge in their views in labor disputes, it seems that he also would probably have dissented had he participated in the case, in which event there would have been a five-to-four decision. Thus a change of heart of a single one of the majority members, or the replacement of but one of them by a newcomer, might result in a decision the other way, if the controversy were to be heard again by the Court.

And if the United States Supreme Court should reverse the Petrillo decision in a short time, it would not be the first time in recent years that the High Court has laid down a decision in a case only to reverse itself shortly thereafter in a suit involving the same question.

Thus, the proponents of the Lea Act, or of any proposed law to prohibit "feather-bedding" in any industry, cannot obtain much consolation from the Petrillo decision.

. . .

NOTE: The Supreme Court remanded the case to the District Court for further proceedings. Trial, conducted by the same District Court Judge, without a jury, resulted in a finding for the defendant. The decision was rendered in January, 1948.

The court failed to find any evidence in the record to show that the defendant "had knowledge or information of or was advised of the lack of need for additional employees," stating that the record was "completely devoid of any evidence indicative of any intention or intimidation on the part of the defendant that these three additional musicians were not to perform actual services."

# Technological Changes in Agricultural Production

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GROSS farm output for human uses in the United States was 27 per cent larger for the war years 1942-44 than for the prewar years of 1935-39. The level of production for 1935-39 was only 10 per cent above that for the period after World War I, although there has been a steady upward trend in the volume of agricultural production since 1920, with the exception of the drouth years of 1934 and 1936. The reasons for the upward trend in agricultural production for the past twenty-five years and the great expansion in the period 1940-46 warrant careful analysis, since during this period there was a decline in farm workers and the area of cropland remained relatively unchanged.

## Expanded Use of Tractor Power and Labor-Saving Machines

The change from horse to tractor power was the most important factor accounting for the upward trend in agricultural production from 1920 to 1946. From about 246 thousand tractors in the United States in 1920 the number increased to 2.5 million in 1946. The number of horses and mules declined from 25.5 million to 9.1 million in the same period. This decline in the number of power animals made

available about 55 million acres (an increase of 15 per cent) of cropland for the production of products for human consumption. This land had formerly been used to raise feed for work animals. By this substitution, the farmer shifted to industry the task of producing both power and fuel and thereby increased the proportion of total farm operating costs which are cash costs. This shift will work to the farmers' disadvantage in a depression period when farm prices drop faster than costs.

## Labor-Saving Machinery

The increased use of tractors was accompanied by the introduction of many types of machines which have done so much to reduce the burden of hand labor and the hours of labor input per acre. The mechanical corn picker and the combine are machines which have been widely adopted and which have reduced materially the hours required to produce corn and small grain crops. The expansion of soybean production from 4.9 million bushels in 1924 to 196.7 million bushels in 1946 would not have occurred without the combine. A partial list of other important machines includes the following: tractor-drawn cultivator, power mower, field ensilage cutter, pick-up baler, mechanical

beet lifter and topper, and multirow planter.

The use of pneumatic tires for tractors and other farm equipment made these machines much more mobile than before, facilitating their use for custom work and for the exchange of work among neighbors which was an important phase of securing efficient use of labor and scarce machines during the war period. The widespread adoption of electric power for tasks performed at the farmstead is another change which should not be overlooked. The mechanical cotton picker and the flame cultivator have not yet been generally adopted but appear now in the position occupied by some of the above-named machines twenty-five years ago. Their effect on agriculture in the South may be outstanding in the period which lies ahead.

### **Crop Production Per Acre Increased**

Increased crop production per acre was one of the important factors in the record wartime production. Crop production per acre averaged about 20 per cent higher during the war years than for the period 1935-39. As indicated previously, total cropland changed very little from 1920 to 1946. Average production per acre for all cropland deviated only slightly from the 1935-39 average in the period 1919 to 1932 but dropped to a record low level in the drouth years of 1934 and 1936. The increase from the low of 1934 to the high level of the war period was very striking.

*Improved Crop Varieties.* The adoption of improved crop varieties contributed to the high acre yields of the war period. The very rapid adoption of hybrid seed corn increased the yield of corn 10 to 20 per cent. New varieties of oats were used in the Corn Belt and the Lake States, and higher-yielding strains of wheat were introduced also.

*Favorable Weather.* Part of the increased yield in the period 1941-46 may be credited to favorable weather, as there were no major drouths during this period and in several years very favorable harvesting weather prevailed during the fall months. The weather was not favorable during all seasons of this period, however, as corn and soybean planting in the Corn Belt was delayed by excessive rains each spring from 1943 through 1947. In 1943 Illinois had more than twice a normal rainfall in May so that by the end of the month only 15 per cent of the corn crop was planted when planting should have been completed. In addition, much of the soybean acreage was unplanted. With horses for power, much of this acreage would never have been planted since animals can work only a limited acreage per day. With tractor power, however, the bulk of the corn and bean crops was planted in a two-week period. The tractors were used long hours; those equipped with lights were often operated 24 hours a day; and the rate of travel was pushed to the maximum. Mechanization, therefore, must be credited with part of

the increased yield per acre and with maintaining the acreage in crops during a period when farm labor was scarce.

*More Fertilizer.* Average yields were also increased by the expanded use of fertilizer. The Bureau of Agricultural Economics analyzes this situation as follows:<sup>1</sup> "Measured in plant nutrients [nitrogen, phosphorus, and potassium], the total consumption of commercial fertilizer in 1944 was 85 per cent above the quantity used in the prewar years 1935-39. Application of liming materials was nearly three times as large as in the prewar years. Based on estimates of additional output from increased use, it appears that increased production resulting from additional use of lime and fertilizer in 1944 accounted for 14 to 15 per cent of the total increase in output over 1935-39."

### Expanded Livestock Production

The increased crop production provided the basis for the expanding of livestock production during the war period through an increase in the number of animal units on farms. Livestock numbers normally change in cycles, and a low was recorded in 1937 as a result of the abnormal liquidation which took place as the result of the drouths of 1934 and 1936. Livestock number by 1941 had returned to a level about 10 per cent above the 1935-39 average,

and by 1943 had experienced a further increase of 20 per cent, which marked an all-time high. The volume available for consumption was further augmented by an increase in production per animal unit of breeding stock—an upward trend which had been under way since 1920. The wartime increase in livestock production, therefore, resulted from increases both in number of breeding animal units and in production per unit.

Livestock production was further increased during the war period through the utilization of large supplies of feed grains and wheat which had accumulated during the period 1937-1941. At the beginning of the war, we had on hand a record carry-over of feed grains; these were converted into livestock and livestock products during the war years.

### Decline of Agricultural Workers

The large volume of agricultural production of the war period appears even more striking when the reduction in the total supply of farm labor is considered. The effect of mechanization on the labor supply began about 1927. The number of farm workers increased 4 per cent between 1919 and 1926 but thereafter had declined 7 per cent by 1934. There was a slight increase in the number of workers in 1935, but in 1936 a downward trend was again under way and in 1945 there were 12 per cent fewer workers than in 1935. The production per worker was up 45 per cent.

<sup>1</sup>*Changes in Farming in War and Peace*, by Sherman Johnson, Bureau of Agricultural Economics, United States Department of Agriculture, June, 1946.

## Analysis from Illinois Farm Account Records

In the United States as a whole, mechanization of agriculture is far from complete, as the use of tractor power and the related machines has progressed much faster in some areas than in others. The shift from horse and mule to tractor has been rapid in the Great Plains, the Corn Belt, and the Western States. Mechanization is more complete in some portions of Illinois than in others. A survey conducted by the Bureau of Agricultural Economics, United States Department of Agriculture, indicates that over 99 per cent of all plowing in the northern two-thirds of Illinois in 1946 was done with tractors, whereas in the southwest district only 79 per cent and in the southeast district 86 per cent was plowed with tractors. The percentage of corn harvested with mechanical corn pickers ranged from 97 per cent in East Central Illinois to 29 per cent in the southwest district. These variations in the use of tractors and machines result from differences in size of farm, productivity of the soil, and importance of the corn crop.

A recent analysis of detailed cost and farm account records for Illinois reveals some interesting facts relative to long-time trends in the use of labor and power not available from national statistics. The study is for the period 1926 to 1945 and the number of records per year ranges from 894 to 3,164. These records are from farms larger than average in size and well mechanized. Practically all of them

use tractor power, as well as mechanical corn pickers and combines for grain harvest. This sample will be contrasted with the averages from the United States, which include many farms operated with horses.

### *Labor Input Per Acre of Crop.*

Detailed cost records that are available for East Central Illinois for the period 1920 to 1945 provide information relative to inputs of labor and power by crops and livestock enterprises. The following data show for the account-keeping farms the tremendous decline in labor input per acre of grain crops which took place during the period of mechanization:

<i>Crop</i>	<i>Hours of Man Labor Per Acre</i>	
	<i>1920-1922</i>	<i>1943-1945</i>
Corn.....	14.4	6.6
Wheat .....	11.6	3.6
Soybeans .....	13.4	4.0
Oats .....	6.6	3.0
Alfalfa hay.....	15.4	12.5

With complete mechanization, the labor input per acre of grain crops has been reduced from one-half to one-third of that required in the earlier period, when horse power was used. The labor input for hay-making has been reduced less than that for grain crops, but this operation is rapidly changing at the present time with the use of more one-man pick-up balers and field forage cutters.

Since acre yields have averaged high during recent years, the reduction in labor input per bushel of grain has been even more striking than on the acre basis. The time

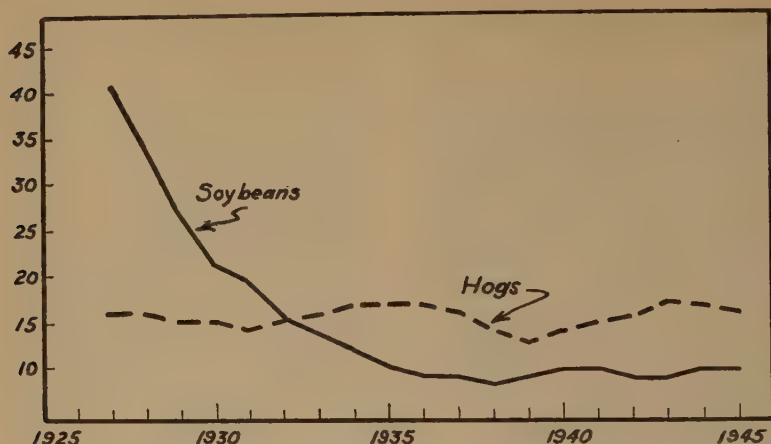


FIG. 1. MINUTES USED IN PRODUCING 10 POUNDS OF HOGS OR ONE BUSHEL OF SOYBEANS, 1926-1945  
(Midyear of 3-year averages)

required to produce and harvest a bushel of corn dropped from 16 minutes in 1926 to 6 minutes in 1946. The time needed to produce a bushel of soybeans decreased from 41 minutes to 10 minutes, and for oats from 11 minutes to 5 minutes, in the 20-year period.

No similar decreases in labor requirements for livestock production have occurred. Production of 10 pounds of pork required practically the same amount of labor throughout the 20 years (Figure 1). The same was true of most kinds of livestock. Milking machines reduced the labor requirements for milk production, but on many farms attempts to maintain the health of the herd and to follow sanitation regulations for the care of whole milk have necessitated added labor inputs which

have offset to some extent the saving in labor made by the milking machines.

The labor shortage of the war period, however, focused the attention of farmers on the problem of saving labor on livestock enterprises. New techniques are being developed by a minority group of progressive operators. A few of the new ideas may be listed as follows: blowing of feed directly from grinders to self feeders, piping water to fields, use of larger self feeders and mechanical grain unloaders, power manure scoops, and mechanical barn cleaners. If the majority of these ideas prove practical, we may expect their widespread adoption and a corresponding future reduction in labor input on livestock operations.

*Amount of Labor Per Farm.*

With the sharp reduction in labor per acre of crops it is logical to assume that there would be a reduction of available labor per farm. Statistics for the United States, as previously noted, listed fewer farm workers in 1946 than in 1919. Illinois accounting farms, however, did not show a reduction in the months of labor per farm, as these farms had an average of 20.8 months of labor in 1926 and 20.8 months in 1945. The maximum annual average for months of labor during this 20-year period was 22.3 in the war year 1943, and the minimum was 20.3 in 1934, when a severe drouth reduced the need for harvest labor. No other factor has shown so little variation as the labor available per farm. This may be explained in part by the fact that these are family farms. A random sample survey of Illinois farms in 1946 indicated that 80 per cent of all farm labor was furnished by the operator and members of his family.

The fact that the family pattern has not been changed by mechanization is of great importance. In recent years many writers have predicted that tractor power and mechanization of agriculture would lead to large-scale and corporation farming. Results to date, however, tend to disprove such an assumption, and the influence of family units on agriculture cannot be overlooked. So long as our food and fiber are produced by several million farm families we will continue to have relatively uncontrolled production even in periods of low farm

prices. In agriculture the land, the management, much of the capital, and a high percentage of the labor are fixed factors. That is, the cost cannot be reduced when the volume of production declines. Interest and taxes remain the same; the farmer is the manager, and he cannot fire himself or members of his family; therefore, he continues to produce even when farming is unprofitable.

Although in both agriculture and industry there is a fairly steady upward trend in volume of production over long periods, in the short term the two show marked differences. Agricultural production, as has just been explained, tends to remain stable, even when changes in demand cause wide fluctuations in prices of farm products. In industry, on the contrary, price fluctuations are much less severe, and production shows greater variations in response to changing demands. Farm earnings, therefore, drop to a very low level in periods when the demand is poor, as from 1930 to 1935, but attain a very high level when the demand is good, as in the period 1940 to 1947.

Since the amount of labor per farm has remained unchanged while the labor input per acre has declined, the question naturally arises, "What has become of the surplus labor?"

*Increase in Size of Farm.* The average acreage of accounting farms increased from 199 in 1926 to 255 in 1945, an advance of 28 per cent. With no change in the labor per farm, the labor per 100 acres, on the 1935-39 base, declined

from 112.3 per cent in 1926 to 91.9 per cent in 1945. It will be noted, however, that the increase of 28 per cent in average size of farm was not so large as the percentage reduction of labor input per acre of crops.

*Hours Worked Per Month.* Central Illinois farmers who kept detailed labor records worked 251 hours per month in 1923 but only 190 hours per month for the four years 1937-1940. As a result of the labor shortage during the war period and the desire to produce at a high level, the hours worked per month increased to 226 in 1943 but declined again to 209 in 1945.

Consideration of all facts bearing on the problem of farm labor leads to the conclusion that farmers have not been able to expand their operations through adding more land or intensive enterprises to compensate for the labor released by mechanization; instead, there has been a reduction in the hours worked by each worker. Since farmers traditionally work longer hours than most other groups, some operators may have chosen to use the time saved by mechanization for leisure, rather than to increase the size of their farm business.

Data collected from Illinois farms by the Bureau of Agricultural Economics indicate that the average length of the farm work day for operators is about 12.5 hours during the summer months and 10.5 hours per day in the slack season. Hired workers average 11 hours in summer and 9.8 in the winter months. There is no overtime paid

for farm work. The days worked per week average less in the winter than in the summer.

Agricultural labor has seasonal peaks which cannot be avoided even with mechanization. The ground must be worked when it is in good condition. Timeliness in planting, cultivating, and harvesting crops is of great importance. The corn and soybean planting seasons for the period 1943-1947 will long be remembered by Illinois farmers because of the rainy weather during the normal planting period and the necessity of working round the clock when the fields were finally dry enough to plant.

### **Production Per Month of Labor on Highly Mechanized Farms**

The Illinois accounting farmers marketed twice as great a volume of agricultural products per month of labor in 1944 as in 1928 (Figure 2). As indicated previously, this tremendous increase in the production of crops and livestock in the 16-year period was due both to increased total volume of products and to decreased input of labor per acre. Each worker was associated with more land and more capital. The increase in production on the more completely mechanized farms of the Illinois account-keepers is much greater than that for the average of all farms in the United States, since the latter include many farms that are still operated with animal power. For the United States the increase was 37 per cent from 1919-1944. The per acre index of production on the Illinois account-

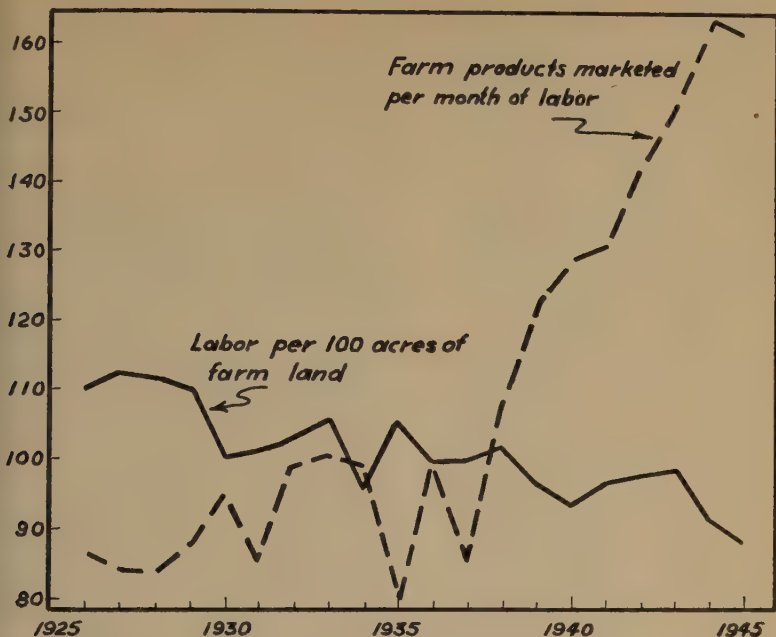


FIG. 2. INDEX NUMBERS OF QUANTITIES OF FARM PRODUCTS MARKETING PER MONTH OF LABOR AND MONTHS OF LABOR PER 100 ACRES OF FARM LAND (1935-1939 = 100)

ing farms increased from 93.5 in 1928 to 153.1 in 1944 (1935-39 = 100), or 64 per cent.

*Will the Production Per Worker Continue to Increase?* The contrast between the highly mechanized Illinois accounting farms and the average of all farms in the United States suggests that if more farms are mechanized the production per worker will be further increased. The supply of farm machinery has been far below the demand since 1941, and a part of this demand is for new types of machines, and for tractors on farms where tractors

have never been used before. It is likely that small power units will be developed for small farms and thus the replacement of horses and mules will continue. The labor saved by a one-plow tractor, however, is very much less than that saved by a two- or three-plow size; therefore, the increase in labor efficiency will be less on the small farms than on those where two-plow or larger tractors are adopted.

The greatest potential saving of farm labor for the United States as a whole is in connection with cotton production, in which the mechanical

cotton picker and flame cultivation give some promise of replacing hand operations entirely for this important crop. If the production of cotton is mechanized, there will be drastic changes in the number of farm workers needed in the South and, no doubt, changes in the prevailing type of farm organization.

### **Agricultural Production in the Postwar Period**

The agricultural plant is in a position to continue for the years that lie ahead a level of production much above our prewar domestic consumption. This fact raises the following question: "What will happen to farm prices when the domestic demand declines and the volume of agricultural exports shrinks?" That farm prices will decline under these conditions is obvious, but the extent of the decline and its timing are not so easy to predict. Needless to say, when

the decline comes, we will again hear about farm surpluses and talk of reducing production, rather than a lack of demand and a need to keep capital and labor fully employed.

Those who recommend reduced agricultural production under these circumstances should pause to reflect that the well-being of our people must be measured in terms of goods and services available per capita and that an optimum level of living can be achieved only when all factors of production are being employed at a high level of efficiency. The upward trend in agricultural production per month of labor is a step toward a higher level of living. It is hoped that organized agriculture will insist that labor and capital cooperate to maintain a high level of employment and production in industry, so that agricultural and nonagricultural prices may move at a more nearly uniform rate.

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**Rate of Saving Should Govern.** If restraint is exercised, the things which people are now trying to do all at once can be done over a longer period, more efficiently, and at a lower real cost. The rate at which the rebuilding of industry, rehousing of people and all the other things we are trying to do are carried out should be governed by the rate of saving. It is the effort to do all these things faster than savings accumulate which results in recourse to credit. The rate at which credit is expanded should be governed by the rate of increase in production. Credit expansion faster than production can be enlarged is inflation. In essence, consumers and industries alike are trying to get through a gate all at once, and at a time when the passage is narrowed to make room for foreign aid. Anti-inflationary action requires standing in line, and easing the congestion. — From the January letter of the National City Bank of New York.

# The Public Debt, Interest Rates, and Inflation

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CONGRESS chose to finance nearly 60 per cent of the government's expenditures during World War II by means of borrowing, and the Treasury, in turn, availed itself of the money-creating mechanism of the commercial banking system in order to effect this borrowing at exceedingly low and stable rates of interest. During the period from December 31, 1940, to June 30, 1945, the national debt rose \$206.4 billions, but of more significance is the fact that \$86.0 billions, or 42 per cent of this increase, was absorbed by the commercial banks and the Federal Reserve System. This type of financing was, of course, the high road to inflation.

The building up of inflationary forces did not cease, however, with the termination of the war. In view of the magnitude of the Federal debt it was deemed imperative to continue the low-rate policy, with the result that the monetary authorities have been unable to prevent a tremendous postwar expansion of bank credit from adding still further to the volume of deposits and currency. Between December, 1940, and September, 1947, the currency in circulation rose from \$8.7 to \$28.5 billions, while the adjusted demand deposits of com-

mmercial banks increased \$49.2 billions, or 141 per cent. During the same period time deposits more than doubled. In all, \$97.7 billions has been added to the country's money supply since 1940.

When the inflationary force of an excessively swollen money supply was released by the premature lifting of controls and then augmented by a further credit expansion, inflation was inevitable.

Several factors not directly traceable to the war financing are contributing to this inflation, but, nevertheless, the present situation is for the most part a heritage of the taxation and borrowing policies adopted in the financing of World War II.

## How the War Was Financed

Two of the principles which the Treasury laid down as guides in conducting its borrowing operations were stated as follows:

(1) The necessary funds should be raised in such a manner as to minimize the risk of inflation;

(2) The cost of financing the war should be kept at a reasonable level.

It is apparent that these principles are in fundamental conflict. To minimize the risk of inflation meant restricting bank participation in the borrowing program; but, on the

other hand, the ability and willingness of the banks to absorb all offerings not taken by the public was, and still is, the essential condition for low-cost financing.

In view of the magnitude of the borrowing operations necessitated by the Congressional tax policy, it is at least understandable that the Treasury should elect to subordinate the risk of inflation and to finance the war at exceedingly low and stable rates of interest.

That the Treasury was entirely successful in maintaining its pattern of rates on government securities (actually a declining average rate) should occasion no surprise. An operator in the market for any commodity, if he has unlimited funds available, can set the price. The Federal Reserve System was such an operator in the market for government securities.

The day after our entry into the war the Board of Governors announced that the Federal Reserve System was prepared to use its powers to "assure that an ample supply of funds is available at all times for financing the war effort and to exert its influence toward maintaining conditions in the United States Government security market that are satisfactory from the standpoint of the Government requirements."

This meant simply that the commercial banking system was to be relied upon to absorb that portion of the government debt which non-bank investors refused to purchase or hold at the low interest rates set by the Treasury. The key problem,

therefore, was that of furnishing reserve funds to the member banks.

During the war the reserves of the member banks were subjected to a terrific drain. Between December 31, 1941, and September 30, 1945, the currency in circulation rose \$16,780 millions, required reserves increased \$4,729 millions, and the gold stock fell \$2,660 millions, while other factors absorbed an additional \$235 millions of reserves. In all, a total of \$24.4 billions of additional cash was needed by the commercial banks.

During the calendar year 1941, \$3,731 millions, or 71 per cent of the additional cash requirement of the commercial banks, was supplied from excess reserves, but a further decline of \$2,326 millions between December 31, 1941, and September 30, 1945, furnished less than 10 per cent of the funds absorbed during this period. Thus \$22,286 millions of additional cash was made available to the member banks; of this total \$20,658 millions, or 93 per cent, reflected an increase in the government securities portfolio of the Federal Reserve System.

The Federal Reserve policy of standing ready to purchase government securities at par made it possible for the commercial banks to absorb \$64 billions, or 31 per cent of the wartime increase in the Federal debt, and this bank absorption in turn enabled the Treasury to maintain, until recently, a pattern of rates on government obligations ranging from  $\frac{3}{8}$  of one per cent on 3-month Treasury bills to  $2\frac{1}{2}$  per cent on long-term bonds.

## Results of War Financing

The policies adopted in connection with the financing of World War II and the continuation of the Treasury's low-rate policy in the postwar period have substantially altered the environment in which the traditional weapons of monetary control have previously been employed. At the present time the Federal Reserve authorities are able to exert only a relatively minor influence over the volume of spending.

Most of the increase in bank deposits and currency which has occurred since the start of the war resulted from an increase in the government security holdings of the commercial and Federal Reserve banks, and this money can therefore be destroyed only by getting the government debt out of the banks. Approximately \$6 billions of government debt was shifted from the banks to non-bank investors during the first eleven months of 1947, but there is no assurance that this rate can be maintained in the coming months without an increase in the interest rate on government securities.<sup>1</sup>

<sup>1</sup> The existence of this tremendous volume of money which cannot be easily and quickly reduced compromises the control powers of the Federal Reserve System, but it is not necessarily true that this relative inelasticity of the money supply is wholly undesirable. It is difficult to predict the nature of future economic disturbances, but the very fact that the supply of money and bank deposits need not contract violently in case of recession or depression might considerably mitigate any business decline and make recovery therefrom much easier.

To increase the portion of the debt not held by banks would not, however, entirely solve the problem. It is apparent that savings bonds and notes, being demand obligations, are essentially the same as cash to the investor, but with Federal Reserve support the marketable obligations also can be readily liquidated with little or no loss and are, therefore, in effect demand obligations. It is true that from the point of view of an individual investor any sound asset can be turned into cash through sale—perhaps with little or no loss. This does not hold for the public as a whole, however, and if many investors are trying to liquidate at the same time a fall in the market price is sure to occur. Herein lies the essential difference between government securities and other types of investments. Turning a part or even all of the public's holdings of government securities into cash would occasion little, if any, decline in the market prices of these obligations, provided the Federal Reserve banks purchased all securities offered at or near par. No other commodity possesses this characteristic.

So long as interest rates are controlled, investors can shift their liquid assets easily, suddenly, and with little or no loss, from one type of holding to another. They can shift from government securities to bank deposits and currency and back again to government securities. The monetary authorities have no alternative but to alter their policy in accordance with the desires of the public. This means that

the banking system is the underwriter for past, as well as for any future, government deficits.<sup>2</sup>

A reduction in the volume of outstanding savings securities or a desire on the part of non-bank holders to liquidate a portion of their marketable securities would, in the absence of a budget surplus, force the Federal Reserve System to make possible a further bank absorption of the debt. The results of such liquidation would be an expansion of bank credit, but it would be an expansion unrelated to the needs of trade or of the economy except by accident.

It is apparent that a tremendous inflation could occur without further lending by banks to individuals and businesses and that the monetary authorities would be unable to do anything about it.

The desire of investors to liquidate all or part of their government securities might be prompted by various considerations. A further increase in prices might lead present holders to turn their government securities and cash into goods in order to hedge against the inflation, or an increase in the demand for capital might induce large investors to get rid of their government holdings, in order to take advantage of more remunerative investment opportunities. Nonfinancial enterprises might desire to buy new equipment and to expand their facilities. It is quite possible that the start of a

business decline could precipitate a large-scale liquidation of government securities.

Regardless, however, of the cause of the liquidation and regardless of whether it took the form of cashing in savings bonds, failing to replace maturing marketable securities, or the actual sale of outstanding obligations, the problem created would be the same. It would be necessary to find other investors who would be willing to absorb with no increase in interest that portion of the debt which present owners no longer desired to hold. These other investors would be the commercial banks and the Federal Reserve System; if the commercial banks were not in the market or were themselves liquidating government securities, then the Federal Reserve System would be the sole residual buyer. Purchases by the Federal Reserve would increase member bank reserves directly, but purchases by the commercial banks would have virtually the same effect since government securities in the portfolios of the commercial banks are practically the equivalent of cash.

It is unlikely that the rates of interest on non-Federal securities could rise very much in response to an increased demand for capital, since acquisition of government securities by the banks would continually expand the supply of funds available for investment. It is entirely possible, however, that the upward pressure could continue until several billion dollars of the debt had been liquidated. Some shifting from government securities

<sup>2</sup> Assuming that Congress would, if it became necessary, lower the reserve requirements of the Federal Reserve banks.

to other investments has already begun, and in view of the great increase in the demand for capital and the widening spread between the yields on government bonds and other types of high-grade securities it is very probable that this trend may continue.

So long as interest rates are controlled, banks are provided with a medium for obtaining funds, without borrowing, with which to expand other types of loans and investments.<sup>3</sup> On the basis of reserves obtained by selling short-term obligations to the Federal Reserve System (either directly or indirectly), the banks are in a position either to increase their loans or to bid up the price of bank-eligible government bonds, thereby encouraging their sale by non-bank investors. The end result of such action is, of course, a multiple expansion of bank credit and not simply a dollar-for-dollar transfer from one type of investment to another.

Of special concern to the Federal Reserve authorities has been the tendency of the commercial banks

to reach out for the longer-term, higher-yielding government securities. During the period from December 31, 1945, to June 30, 1947, the government bond holdings of the insured commercial banks rose \$2.2 billions; \$1.4 billions of this increase occurred since June, 1946. The total volume of marketable government bonds outstanding remained substantially unchanged during this period. In addition to this debt monetization, a further inflationary factor has been the vast postwar expansion of commercial bank loans. From June 30, 1945, to October 29, 1947, the loans of all commercial banks rose \$13.3 billions. The seven-billion-dollar increase which occurred during the twelve-month period ending September 30, 1947, was greater than for any comparable period in the history of American banking.

Some of these loans facilitated re-conversion from wartime to peacetime production and perhaps were deflationary to some extent, but that in general this expansion was inflationary is beyond question. It is a common belief that no restriction need ever be placed upon the lending activities of the banks, so long as the loans made are for the purpose of facilitating the production or marketing of commodities. These "good" loans, it is argued, increase the supply of goods and are therefore deflationary. It is not made clear, however, just how the volume of production is to be materially increased when the factors of production are for the most part already fully employed. Also in this

<sup>3</sup> Short-term securities would be subject to very little depreciation in value even though interest rates were not pegged by Federal Reserve action. This fact would not render them the equivalent of excess reserves, however, since sales of short-term securities to the public would increase total reserves only to the extent that they were paid for in currency. In the absence of a low-rate policy, the Federal Reserve would certainly not purchase short-term securities from the banks in order to bring about an undesirable expansion of bank credit.

connection it should be noted that the deposits created by the banks are not destroyed by the initial spending. Certainly the \$6.1-billion increase in consumer and real estate loans which occurred during the 18-month period ending June 30, 1947, contributed substantially to the postwar price rise.

Under the policy adopted, the Board of Governors was powerless, however, to prevent the excessive postwar expansion of bank credit. Either their quantitative control weapons were too weak to be effective or else the low-rate policy precluded their use. Large-scale open-market sales, except to offset an increase in reserves from other sources, would have necessitated a sharp rise in the short-term interest rates, whereas simply raising the rediscount rate would have put very little pressure on the banks, which were not rediscounting to any substantial extent. The Board of Governors did have power to raise the reserve requirements against the demand deposits of Central Reserve City banks from 20 to 26 per cent. Although this action should have been taken, it would have prevented only a relatively small proportion of the total postwar bank expansion. The existing powers of the monetary authorities are simply inadequate materially to reduce the availability of bank credit without increasing the interest cost to the Treasury.

Admittedly there is little likelihood that the banks will exchange a large proportion of their government securities for excess reserves

unless the interest rates on other types of loans and investments increase substantially relative to the rates on government securities. Considerations of liquidity would probably induce the banks to stop the process long before half, or even a third, of the bank-held debt had been liquidated. A further liquidation of from \$5 to \$10 billions is, however, quite possible, and on the basis of \$10 billions of excess reserves the commercial banking system can expand loans and investments approximately \$60 billions.

Some students of the problem contend that the monetary authorities should relinquish their control and permit interest rates to find their own level in a free market. Having been relieved of their obligation to maintain the existing pattern of rates, the monetary authorities would then be free to bring sufficient pressure on the commercial banks to check the rapid expansion of bank credit. Since government securities could no longer be turned into cash or excess reserves at the will of the public or the banks, the automatic operation of our modern printing press would be halted. There is no doubt that the withdrawing of support and the application of pressure on the banks would effectively deal with the excessive expansion of bank credit, but on the other hand such action would create difficulties and might be highly dangerous.

In the first place, higher interest rates would increase the significance of the interest burden as a

factor in the determination of budget policy. It would mean either less funds available for the Treasury's debt retirement program, or higher taxes, or both. Admittedly, a somewhat higher interest burden would be a small price to pay for checking the price rise and bringing about economic stability. The disadvantages of a moderate addition to the fixed costs of the government cannot be compared with the disastrous consequences of continued inflation. On the other hand, with an average rate on government securities of 3 or 4 per cent, the problem involved in meeting the interest payments might be so great as to overshadow all other objectives of fiscal policy, and the efficacy of fiscal policy as an instrument which could be employed to help maintain economic stability would be seriously limited. So large an average rate would probably make necessary the monetization of a part of the debt either by direct borrowing from the Federal Reserve at a low rate or by the issue of some type of Treasury currency. It may be contended that a substantial rise in interest rates is unlikely in the foreseeable future, even in the absence of Federal Reserve control. This, however, is purely conjecture. If interest rates should rise substantially and the monetary authorities found it expedient to resume control to prevent a further increase, then we would be right back where we started except for the fact that interest rates would be higher.

It seems doubtful that moderately higher interest rates would materially decrease the demand for bank credit. Individuals who borrow for purposes of consumption are relatively insensitive to changes in interest rates, and the decisions of most businessmen would be little influenced by an alteration of one or two percentage points in the rates at which they could borrow from commercial banks. Interest cost is a small part of their total cost in most cases.

Some writers contend that if rates on short-term government securities were materially increased then bankers would be less inclined to liquidate such holdings in order to increase other types of loans and investments. However, if other short-term rates increased also, as would be quite likely, then this effect would for the most part be nullified.

Increasing interest rates would complicate the Treasury's refunding operations. Investors would tend to defer purchases in anticipation of still higher rates, and a shattering of public confidence in the implied promises of the Treasury and Federal Reserve officials would further increase the Treasury's difficulties. The problem would be immediate, since \$3.5 billions of government bonds with high coupons will mature in 1948. A dropping bond market would certainly not simplify these refunding operations.

The strongest argument for maintaining the existing rate pattern concerns the severe repercussions which might result from a falling bond market. Some students of the

problem predict nothing less than catastrophe should government bonds be permitted to go below par. According to them, government bonds below 100 would precipitate panic in the bond market with wholesale dumping of marketable Treasury obligations. The psychological impact would be so great as to affect the holders of demand obligations, with the result that a deluge of savings bonds would be presented to the Treasury for redemption. In short, complete demoralization would occur.

It is true that these persons may be unduly alarmed and their dire predictions may not materialize, but in view of the magnitude of the debt and the knowledge that depression would probably greatly reduce revenues who can say with certainty just how investors would react? My own view is that the present situation does not warrant experimentation.

During the last few months a slight upward adjustment in the rates on short-term government securities has been permitted, but this does not mean that the monetary authorities intend to relinquish control. At most it signifies a shift of emphasis from the short- to the long-term rates. Just where the ultimate support level for government bonds will be is unknown, but it may be significant that the Federal Reserve entered the government bond market about the middle of November when the longest-term Treasury bonds—the restricted 2½'s sold in the Victory Loan drive—reached 101 and during the fol-

lowing two weeks added \$163 millions to its portfolio of "5 years or over." It appears from these operations that the monetary authorities have no intention at this time of permitting government bonds to sell below 100.

The higher short-term rates and the unsettled conditions in the bond market have lessened the inducement for banks to lengthen the maturity distribution of their holdings of government securities, but the effect on bank lending will probably be slight.

In addition to the rate increase, the chairman of the Board of Governors has confirmed the rumor that the rediscount rate is to be raised to 1¼ per cent, but this fact is of minor significance since it is essential that the rediscount rate be higher than the rate on certificates of indebtedness.

If the Federal Reserve authorities are to exert any appreciable influence on the lending policies of the commercial banks without breaking the bond market, then they must be provided with more appropriate weapons than they now possess. One method of restoring a measure of control to the Federal Reserve would be for Congress to grant additional authority to the Board of Governors to raise the traditional reserve requirements against net demand and time deposits of the member banks. The application of this weapon would put a brake on the excessive expansion of bank credit, but, unlike forceful open-market operations, it would not necessitate the abandonment of the

controlled rate policy. Since interest rates on government securities need not increase, there would be little danger of demoralizing the bond market. Strong support would probably be necessary, however, and a sharp, although perhaps temporary, increase in Federal Reserve holdings of government securities would probably occur. The extent of the increase in reserve requirements which Congress should allow is debatable, but it would probably be appropriate at the present time to make the existing maximum limits the minimum limits and give the Board of Governors the power to raise them to double that amount. Raising the reserve requirements to the maximum suggested here would increase required reserves by approximately \$16 billions and would decrease by 50 per cent the amount of expansion which could occur on the basis of additional reserves. To assure effective control, the maintenance of reserves equivalent to those required for member banks should be made a condition of deposit guarantee by the FDIC.

The actual employment of this weapon might prove to be unnecessary, since the very fact that it exists would tend to bring about a more cautious attitude on the part of commercial bankers. Since they would have to be prepared at all times to meet the new and higher reserve requirements, they would be somewhat more hesitant to liquidate government securities in order to increase other types of loans and investments.

The Board of Governors should raise the reserve requirements against the demand deposits of Central Reserve City banks to the maximum authorized by law—that is, from 20 to 26 per cent. Admittedly the loans and deposits of these banks have not increased proportionately with those in the rest of the country, and it may therefore seem unfair to single out these banks for action. Nevertheless, the raising of these requirements would tend to restrict bank expansion without danger of severe repercussions, and the action should, therefore, be taken. The proper maximum reserve requirements for any class of banks is a matter that should be decided by Congress, not by the Board of Governors of the Federal Reserve System.

With more appropriate weapons the Federal Reserve authorities can restrict bank loan expansion somewhat, but fiscal policy, not monetary policy, is the real key to inflation control. Lower taxes and large governmental expenditures are appropriate in periods of deflation and depression, but there are no valid economic arguments to support such a policy at the present time. Instead the government's fiscal policy should now be directed toward reversing the process by which the inflationary forces were created in the first place; that is, toward the retirement of bank-held government debt.

Since February, 1946, the Treasury has pursued an anti-inflationary debt-management policy. During the ten months thereafter, the Treasury

retired over \$20 billions of bank-held government debt, the funds for this purpose being obtained from the large War Loan accounts which were built up during the Victory Loan drive. This action for the most part did not affect the reserve position of the member banks nor did it reduce the public's money supply. It was deflationary, however, since the loss of \$20 billions of government securities reduced the liquidity of the commercial banks. Since the end of 1946 the Treasury has continued to pay off bank-held governments with funds derived from trust funds, budget surplus, and the sale of government obligations to non-bank investors. During the first eleven months of 1947, over \$6 billions of government debt was transferred from the banks to other investors. The retirement of bank-held debt through budget surpluses or by transferring it to non-bank holders is highly deflationary, since it tends to reduce both the liquidity of the commercial banks and the public's money supply.

The Treasury should be provided with funds for an intensive campaign to sell savings bonds to the public, and the proceeds from such sales should be used to retire government debt held by the commer-

cial and Federal Reserve banks. To the greatest extent possible, however, the retirement of government securities held by the banks should reflect an actual reduction in the total Federal debt outstanding. An individual's liquidity is decreased far more by the paying of taxes than by the investment of an equivalent amount of funds in demand obligations of the Treasury.

A serious attempt to bring the inflation under control calls for the maintenance of the existing tax rates, together with a courageous attempt to reduce governmental expenditures. The Federal government should set an example for the other government units, business, and individuals to follow. The writer is not suggesting that we should sacrifice any objectives which are deemed indispensable to the future welfare or security of the nation, but some cutting of expenditures can and should be done.

Admittedly the measures suggested above in regard to monetary policy are relatively mild, but more forceful action is unwarranted at the present time, since a proper objective of current monetary policy is stabilization and the continuation of the high level of employment, not deflation and depression.

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NOTE: Since this article was written, the Board of Governors has raised the reserve requirements for demand deposits of Central Reserve City banks from 20 to 22 per cent.

**Outlook for 1948.** The inflationary situation was intensified in 1947, and in January, 1948, the economy seems to be in greater maladjustment than it was in January, 1947. A year ago there seemed to be substantial reason to hope that with intelligent action better balance could be achieved in the economy during 1947. Adjustments seemed necessary, but with moderate restraints it seemed that they could take place and be but mildly deflationary. In the past year, economic unbalance was aggravated. And only to the very optimistic do the inevitable future adjustments now appear "mild." Rather they loom more and more ominous as inflation mounts.—Chester C. Davis, President of the Federal Reserve Bank of St. Louis, in that bank's *Monthly Review*, January 1, 1948.

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**Implications and Prospects.** There appears to be, then, a continuing discrepancy between demand and supply potentials—between our ability to create purchasing power and our ability to create goods. . . . The outlook for 1948 hinges upon the relative strength of upward pressure of prices, on the one hand, and the inequities and distortions—in income and price relationships—that inflation itself generates, on the other. At this stage the drag of distortions does not appear sufficient to offset the tremendous strength underlying demand. And while it is possible that increasing stresses and strains within the economy may bring a downturn sooner than is now apparent, the weight of evidence at this time seems to lean toward more inflation.—From the *Business Review*, Federal Reserve Bank of Philadelphia, January, 1948.

